CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY

FOR
~~DOMESTIC~~ GLOBAL ENHANCED ~~INDEX~~ EQUITY STRATEG~~Y~~IES~~–~~ INTERNALLY MANAGED

February 10,~~4,~~ 2006~~5~~

This Policy is effective immediately upon adoption and supersedes all previous ~~domestic~~ ~~enhanced~~global enhanced ~~index~~ equity strateg~~y~~ies - internally managed investment policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the ~~Domestic~~ Global Enhanced ~~Index~~ ~~Strategy~~Equity Strategies - Internally Managed ("the Strateg~~y~~ies"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Strateg~~y~~ies. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and capturing investment opportunities.

II. STRATEGIC OBJECTIVE

Diversifying the ~~domestic equity~~global equity segment through ~~a~~ risk-controlled, value-added strateg~~y~~ies with a low correlation of returns to the System's other active and passive investments is the strategic objective of the Strateg~~y~~ies.

The Strateg~~y~~ies shall be managed to accomplish the following:

1. Enhance the System's total return;

2. Hedge against active (pre-retirement) liabilities;

3. Provide diversification to the System's overall investment program; and

4. Consider solely the interests of the System's participants and their beneficiaries in accordance with California State Law.

III. RESPONSIBILITIES AND DELEGATIONS

A. The **System's Investment Committee** ("the Investment Committee") is responsible for approving and amending the Policy. The Investment Committee delegates the responsibility for administering the Strateg~~y~~ ies portion of the System through the Delegations of Authority (Delegation Nos. 89-13 and 95-50).

B. The **System's Investment Staff** ("the Staff") duties include, but are not limited to, the following:

1. Developing and recommending the Policy to the Investment Committee;

2. Maintaining a procedures manual for each portfolio, subject to periodic reviews and updates, outlining Staff operational procedures used in implementing this Policy;

3. Implementing and adhering to the Policy;

4. Reporting all violations of the Policy immediately to the Investment Committee. The Staff's report shall include explanations and recommendations;

5. Purchasing only those securities that are outlined in the Policy; and

6. Reporting internally to senior management concerning the implementation of this Policy. The Staff's report shall be prepared monthly and shall include, but not be limited to the following:

   a. Current market value of the portfolio(s);

   b. Performance of the portfolio(s) versus the Benchmark(s) ~~as reported by the prime broker~~; and

   c. Performance attribution analysis that attributes return to its causes.

~~7. The Staff shall develop and maintain specific Watchlist Criteria detailing the qualitative and quantitative factors to evaluate managers.~~

C. The **General Pension Consultant** ("General Pension Consultant") is responsible for monitoring and evaluating the performance of the portfolio(s)~~'s performance~~ and making reports concerning the performance to the Investment Committee. The General Pension Consultant shall report to the Investment Committee, at least quarterly, the performance relative to the Benchmark and Policy guidelines. The General Pension Consultant is responsible for reporting any non-compliance issues in accordance with its responsibilities under its contract with the System.

IV. PERFORMANCE OBJECTIVE

Enhancing the return of a portion of the Internally Managed ~~Domestic Equity~~Global Equity Index Funds is the performance objective of the Strateg~~y~~ies. The performance objective shall be accomplished by ~~obtaining the highest active return at the specified target active risk level~~ seeking to maximize a portfolio's active return within a specified active risk level.~~.~~

V. INVESTMENT APPROACH AND PARAMETERS

A. Investment Approach (Domestic Quantitative Factor Model)

The Domestic Quantitative Factor Model portfolio is an active strategy utilizing statistical techniques to define common market factors forming excess return forecasts. To achieve the stated performance objective, the Strategy uses four components in the active equity investment process: Stock Selection, Risk Control, Transaction Cost Control, and Portfolio Construction. The four components are described as follows:

1. Stock Selection

The Strategy uses a quantitative stock selection model to estimate the expected relative return of all stocks within the stock selection universe. The stock selection universe shall be the Wilshire 5000 Index. The stock selection strategy shall diversify across many different types of factors to avoid heavy reliance on any one source of returns should a factor underperform for an extended period. The expected factor returns in the stock selection strateg~~y~~ies shall adapt over time with the realized factor returns.

2. Risk Control

The initial target level of risk in the active portfolio shall be 50 basis points above the base level of active risk in the set of instruments used to mimic the Benchmark. The maximum target level of risk in the active portfolio shall be 300 basis points above the base level of active risk in the set of instruments used to mimic the Benchmark.

The level of exposure to common factors associated with undesirable risk in the active portfolio shall be minimized by applying an increasing penalty to such exposures. Holding a large number of stocks shall diversify the level of specific risk in the active portfolio. Additionally, the percentage weight of any stock in the active portfolio shall be constrained to be less than ±2% to further control the specific risk of individual stock positions.

3. Transaction Cost Control and Trading Activity

A model of the fixed and variable transaction costs shall be used to offset expected returns by the costs of trading. As a result of such action, the amount of portfolio turnover shall be determined within the optimization process. The forecast of trading cost for each stock shall be based on it's bid/ask spread, historical volume and volatility, and the market center in which it is traded.

The Strategy shall use a variety of trading techniques and liquidity sources to obtain best execution of the trade list.

4. Portfolio Construction

At least monthly, ~~(or more often, as needed)~~ an optimization process shall be performed. The optimization process shall ensure that valuable, time-sensitive stock selection information is implemented in a timely manner and that the portfolio risk characteristics are adequately controlled. The System shall continually monitor and improve the estimates for expected returns, risks, and transaction costs in order to maximize the actual value added to the Strategy from the active investment process.

B. Investment Approach (Fundamental Weighting Model)

The Fundamental Weighting Model portfolio is a strategy utilizing company-specific accounting measures to determine security weights. To achieve the stated performance objective, the Strategies use three components in the active equity investment process: Stock Selection, Risk Control, and Portfolio Construction. The three components are described as follows

1. Stock Selection

Portfolios managed utilizing fundamental factors shall have security selection and weights derived from parameters measuring a company's business success. Currently the parameters used are company sales, book value, dividend yield, and cash flow. The specific parameters and method of calculation security weights shall evolve over time, dependent on the efficacy of the model.

2. Risk Control

The expected tracking variance of fundamental factor based portfolios versus market capitalization benchmarks is currently approximately 400 basis points. The mechanism for monitoring and controlling tracking variance within expectations shall be described within the strategy's procedures manual.

3. Portfolio Construction

The applied portfolio construction method shall vary as the fundamental factor strategy is deployed in different market segments. Data in the form of fundamental factor based security universes and weights shall be obtained from Research Affiliates LLC (RALLC) and FTSE. This data shall represent the raw information underlying the portfolio construction process.

The strategy shall use discrete portfolios in the domestic and international regions. This division is in recognition of the different benchmarks CalPERS applies to these segments and also to facilitate maintenance of the domestic / international global equity asset allocation.

Where a portfolio resulting from an approximate replication of the fundamental factor derived weights provides an acceptable expected tracking variance, this shall be the construction method utilized. Should a replication of the fundamental factor weights result in expected tracking variance exceeding anticipated levels, alternate portfolio construction methods such as sampling and optimization shall be used to control the expected tracking variance.

C. Specific Risk Parameters

Specific risk parameters shall limit the return deviation of the Portfolio(s) versus the benchmark. A number of models shall ensure that the risk parameters are within an acceptable tolerance level to achieve the performance objectives. Since the System shall add or eliminate models, the specific risk parameters for each model are detailed in the Procedures Manual(s).

Implementation of this program shall comply at all times with the System's investment policies including, but not limited to, the following:

1. Permissible Country Equity Policy;

2. Foreign Exchange Guidelines;

3. Statement of Investment Policy: Derivatives – Investment Office; and

4. Proxy Voting Policies.

~~B~~D. Restrictions

~~1. Foreign incorporated securities (including ADRs) shall not be held in the portfolio for investment. Such securities received in corporate actions or through a change in classification shall be liquidated as is feasible.~~

~~2. The Strategy is prohibited from transacting in shares of Real Estate Investment Trusts (REITs).~~

~~3. To ensure the liquidity of the active portfolio holdings, the active portfolio holdings shall be limited to 200% of the stock's one-month average daily trading volume. Daily trading in any stock is limited to no more than 35% of its one-month average daily trading volume.~~

~~4. The Fund is prohibited from transacting in shares of tobacco stocks.~~

The Portfolios may not purchase the securities of primary tobacco companies as identified by the Investor Responsibility Research Center Tobacco Company List. In addition, the portfolios will, at all times, comply with the System's investment policies including permissible countries, foreign exchange guidelines, derivatives policies, and proxy voting policies.

~~C.~~E Permissible Securities

Equity and associated securities of global publicly traded companies. ~~headquartered in the U.S.~~

~~D.~~F Corporate Actions

~~Corporate actions (e.g., tender offers, mergers, Dutch-auctions, and spin-offs) shall be handled on a case-by-case basis, referring issues that require in-depth analysis to the Research Unit.~~

Corporate actions (e.g., tender offers, mergers, Dutch-auctions, or spin-offs) shall be handled on a case-by-case basis.

Companies which offer discount Dividend Reinvestment Programs (DRIP) and similar programs will be analyzed to determine if return enhancement can be added by participating in such programs.

~~E.~~G Attribution Analyses

~~The portfolio's cash,~~Cash, liquidity, active performance, and risk characteristics of the portfolios shall be monitored and reported through the attribution reports described below in-numbers one through three. The reports shall determine any necessary rebalancing of the actual portfolio or additional model research due to issues highlighted in these reports.

1. Performance Attribution Report

   A performance attribution report shall be generated ~~at least~~ monthly decomposing active performance into that due to common factors, including industries, and that due to stock-specific sources.

2. Forecasted Risk Attribution Report

   A risk-attribution report shall be generated ~~at least~~ monthly decomposing the forecasted active risk into that due to common factors, including industries, and that due to stock-specific sources.

3. Cash Position Report

   A cash report shall be generated ~~at least~~ monthly displaying the account equity, long, short, and net cash balances, and the leverage ratio.

4. Liquidity Report

   A liquidity report shall be generated ~~at least~~ monthly displaying the percentage of total market capitalization of each stock held. The report shall also display the percentage of one-month average daily trading volume, on a total and active basis, and on a portfolio and individual name basis.

VI. BENCHMARKS

~~The benchmark for the Strategy shall be the CalPERS Custom Wilshire 2500 Index ("the Benchmark") excluding REITs and tobacco stocks (with dividends reinvested). This Benchmark is a customized capitalization-weighted portfolio constructed and shall be maintained by Wilshire Associates. The Benchmark's composition is designed to provide broad market exposure to the total U.S. equity market while minimizing transaction costs. The Index is composed of the top 2500 securities of the Wilshire 5000 Index. The Index is based on market capitalization, and is reconstituted annually. The Wilshire 5000 Index measures the performance of all U.S. headquartered equity securities with readily available price data.~~

Independent sources are responsible for maintaining the benchmarks as well as calculating and reporting the return of the benchmarks to the System.

A. Domestic Factor Model: The benchmark for the Fund shall be entitled the "CalPERS Custom Wilshire 2500 Index". This custom benchmark shall be constructed and maintained by Wilshire Associates. It shall be defined as the top 2500 securities of the Wilshire 5000 (excluding REITS and tobacco stocks) with dividends reinvested, and be based on market capitalization and annual reconstitution. Its composition shall provide broad market exposure to the total U.S. equity market while minimizing transaction costs.

B. Fundamental Factor Models:

The benchmark for the domestic portion of the strategy shall be entitled the "CalPERS Custom Wilshire 2500 Index" described above. The benchmark for the international portion of the strategy shall be entitled the "CalPERS Financial Times Stock Exchange (FTSE) All World, Developed, ex US, ex Tobacco, Capitalization Weighted Index". The markets included are limited to the countries in the System's Permissible Country Equity Policy and is calculated on an unhedged basis.

VII. GENERAL

Investors, managers, consultants, or other participants selected by the System shall make all calculations and computations on a market value basis as recorded by the System's Custodian.

VIII. DERIVATIVES AND LEVERAGE POLICY

A. Strategies

Leverage ~~shall~~ may be used in the form of borrowed securities. In cases where the Benchmark portfolio does not contain a large enough percentage of the stock to facilitate the desired percentage of underweighting relative to the Benchmark, borrowing the securities from a broker and selling them short ~~shall~~ can facilitate the additional desired underweighting. The proceeds from the sale of these borrowed securities shall be used to finance the offsetting overweighting of other stocks relative to the Benchmark; consequently, the Strategy remains fully invested.

Financial futures, options, and swaps may be utilized in the portfolio, in accordance with the System's Derivatives Policy, as it may be amended, for the following purposes:

1. To permit the investment of dividends received~~.~~;
2. To equitize cash and dividends receivable~~.~~;
3. To allow adjustment of the portfolio's risk characteristics in the most cost effective and efficient manner available~~.~~; and
4. To facilitate investment of cash flows related to contributions, withdrawals, or asset allocation compliance.

B. Justification

1. Leverage

Necessary to achieve underweights of stocks in the portfolio through short-selling of securities, in accordance with the strategic objective of obtaining the highest active return at the specified target active risk level.

2. Derivatives

~~a. Allow the establishment of a cash buffer.~~

~~b.Used to lower transaction costs compared with the purchase of underlying securities.~~

~~c. High correlation to returns of the Benchmark Index.~~

~~d. Provide the ability to alter risk characteristics versus the Benchmark without disrupting the underlying portfolio or unnecessarily increasing turnover.~~

a. Comparing lower transaction costs with the purchase of underlying securities;

b. Equitizing non-spendable cash exposures (e.g. dividend accruals) to get a highly correlated return on that component of the Portfolio(s);

c. Providing the ability to alter risk characteristics versus the benchmark without disrupting the underlying Portfolio(s) or unnecessarily increasing turnover; and

d. Obtaining matched returns between the benchmark and the Portfolio(s) through investment in custom equity swaps and currency forwards.

C. Restrictions

~~1. Uncovered call writing is prohibited.~~

~~2. Traders are limited in their authorization to trade stock index futures to 1000 long contracts and 1000 short contracts, without prior written authorization from management.~~

Restrictions on the above mentioned derivative strategies include the following:

1. Writing uncovered calls is prohibited;

2. Leveraging is prohibited. The use of futures contracts as specified in this Policy will not constitute leverage;

3. With the exception of equity swaps and currency forwards, trading non-exchange traded derivatives is prohibited;

4. Speculating is prohibited;

5. Use of non-CFTC approved futures contracts is prohibited; and

6. Portfolio specific position limits will be established and monitored as detailed in the applicable procedures manual.

D. Permissible Derivatives

~~Exchange-traded and over-the-counter derivatives shall be utilized in the index portfolio. These may include, but are not limited to the following:~~

~~1.Equity Swaps~~

~~2.Index Futures~~

~~3.Style Futures~~

~~4. Index Options~~

Derivatives utilized in the enhanced index Portfolios may include, but are not limited to the following:

1. Index futures;

2. Style futures;

3. Index options;

4. Currency forwards; and

5. Equity swaps.

E. Futures Commission Merchants (FCM)

~~FCMs are selected based on a broad range of criteria, which includes the following factors:~~

~~1.Low cost clearing and executing charges;~~

~~2.Securely capitalized firm;~~

~~3.Clear account statements and efficient reconciliations;~~

~~4.Responsive personnel;~~

~~4.Discrete and efficient operation;~~

~~5.Personal interview; and~~

~~7. Reference checks.~~

Futures Commission Merchants are selected with the following broad range of criteria:

1. Low cost clearing and executing charges;

2. Securely capitalized firm;

3. Clear account statements and efficient reconciliation;

4. Responsive personnel;

5. Discrete and efficient operation;

6. Personal interview; and

7. Reference checks.

IX. GLOSSARY OF TERMS

Definitions for key words used in this policy are located in the Equity Glossary of Terms which is included in the System's Master Glossary of Terms.

Approved by the Policy Subcommittee:	October 6, 2000
Adopted by the Investment Committee:	February 20, 2001
Revised by the Policy Subcommittee:	December 10, 2004
Adopted by the Investment Committee:	February 14, 2005
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Asset Class Glossary: Equities
Policy: ~~Domestic~~ Global Enhanced Equity~~Index~~ Strateg~~y~~ies - Internally Managed
February 1~~4~~0, 2006

Active Investment Process
An investment process that involves a certain degree of active management as defined below. The objective of an active investment process is to outperform the broad market benchmark.

Active Performance
The return of a portfolio that is in excess of its benchmark return. This is the return of the active portfolio.

Active Portfolio
A portfolio that is comprised of all of the bets against the broad market benchmark. The objective of an active portfolio is to outperform the broad market benchmark.

Active Risk
The volatility of the returns of the active portfolio.

CalPERS Custom Wilshire 2500 Index
The Wilshire 2500 Index, excluding Real Estate Investment Trusts (REITs) and tobacco stocks, and with dividends reinvested. The Wilshire 2500 comprises the top 2500 securities of the Dow Jones Wilshire 5000 Index, excluding REITs and tobacco stocks, based on market capitalization, and is reconstituted annually. The Dow Jones Wilshire 5000 is an index that measures the performance of all U.S.-headquartered equity securities with readily available price data.

Cash Buffer
An amount of the portfolio funds invested in cash equivalent securities, used for varying purposes, such as to avoid the incursion of a debit balance.

Common Factor
An element of return that influences many securities and, hence, is a "common factor" in the returns on those securities. By virtue of their common influence on many stocks, common factors contribute to market return as well as residual returns of the stocks that they influence most. Some common factors for domestic equity are capitalization, beta, price/earnings, price/book, interest sensitivity, and yield.

Common Factor Return
The portfolio return attributable to a particular common factor. Asset returns are decomposed into a common factor component, based on the asset’s exposures to common factors times the factor returns and the specific return.

Common Factor Risk
The risk attributable to the effects of common factors.

Custodian
A bank or other financial institution that provides custody of stock certificates and other assets of an institutional investor.

Derivative
An instrument whose value is based on the performance of an underlying financial asset, index, or other investment. Classes of derivatives include futures contracts, options, currency forward contracts, swaps, and options on futures.

Equity Based Strategy
Combination of active stock selection with risk mechanism designed to minimize tracking error relative to the benchmark. Seek to add value through minor variances relative to the market in sector/industry weightings, style (growth/value) tilts or stock weightings. Key inputs into the process come from either analysts' fundamental research or quantitative models.

Equity Swaps
An agreement between two parties dictating a swap with payments on one or both sides, linked to the performance of equities or an equity index.

Factor Return
See Common Factor Return.

Futures
Contracts to buy or sell a standard quantity of a given instrument, at an agreed price, on a given date. A future differs from an option in that both parties are obliged to abide by the transaction. Futures are traded on a range of underlying instruments including commodities, bonds, currencies, and stock indices.

Leverage
A condition where a portfolio's market obligation may exceed the market-value-adjusted capital commitment by the amount of borrowed capital (debt).

Optimization
The best solution among all solutions available for consideration. Constraints on the investment problem limit the region of solutions that are considered and the objective function for the problem by capturing the investor's goals correctly, providing a criterion for comparing solutions to find the better ones. The optimal solution is the solution among those admissible for consideration that has the highest value of the objective function.

Option
Contracts that give the purchaser the right, but not the obligation, to buy or sell an underlying instrument at a certain price (the exercise or strike price) on or before an agreed date (the exercise period). For this right, the purchaser pays a

premium to the seller. The seller (writer) of an option has a duty to buy or sell at the strike price, should the purchaser exercise his right.

Passive Investment
Investing in a manner that attempts to replicate the characteristics and performance of a market index. In theory, passive investing/management assures investment performance is neither worse nor better than the market as a whole. In practice, actual results differ from the results reported for the index due to transactions costs and tracking error.

Short Sale
The sale of a security that is not owned by the investor but rather is borrowed from a broker. The investor eventually repays the broker in kind by purchasing the security in a

subsequent transaction.

Specific Risk
The risk of the specific return.